

The Liversidge e-Letter

An Executive Briefing on Emerging Workplace Safety and Insurance Issues

October 16, 2009

An Electronic Letter for the Clients of L.A. Liversidge, LL.B.

3 pages

Why the “Mahoney Report” must focus primarily on WSIB fiscal health

WSIB 2009 2nd Quarter Report shows the bleeding continues
Year-to-date revenues short of expenses by a whopping \$1.274 billion

While investments are improving, June 30th year-to-date revenues short of expenses and benefits by \$1.274 billion

The WSIB has released its **2009 Second Quarter Report to Stakeholders** [“June 30 2009 Report”]. As readers of **The Liversidge e-Letter** are aware, the release of relatively current WSIB financial data was long recommended in these pages (see the February 25, 2009 issue, “*Chair Mahoney’s Consultation, The first step: Immediate disclosure*”, and the February 27, 2009 issue, “*The benefit of quarterly financial statements*”). To its credit, the Board released the 2008 Financial Statement May 7, 2009, followed by the 2009 First Quarter Statement June 19th (see June 23, 2009 issue of **The Liversidge e-Letter**, “*WSIB 2009 1st Quarter Report, Unfunded Liability at Historic High*”).

While it has taken a little longer than expected, the WSIB finally released the **June 30 2009 Report** on October 12, 2009. As I expected, due to improvements in the Board’s investments, the Unfunded Liability [“UFL”] has dropped (see the October 5, 2009 issue of **The Liversidge e-Letter**, “*Does WSIB have the moral authority to increase premiums for 2011 or 2012?*”) and as at June 30, 2009 sits at \$11.966 billion, down from the all-time March 31, 2009 high of \$12.380 billion, a not unimpressive decline of \$414 million (-3.3%). (Go to www.wsib.on.ca/ for a copy.)

WSIB investments have improved

Overall, improving investments are the sole reason behind the decline in the UFL. WSIB assets jumped a whopping \$915 million, from \$12.573 billion March 31st to \$13.488 billion June 30th (**June 30 2009 Report, p. 14**). *So good news, right? Well, yes and no.*

WSIB assets and liabilities up

While the Board’s assets are up, during the same period the Board’s liabilities increased \$501 million, thus accounting for a decline in the UFL of only \$414 million.

As the Board explains, “*improvements in investment revenues were partially offset by increases in benefit costs*” and “*decreases in premium revenue*”.

Global financial crisis continues to get much of the blame

Much of the blame for this continues to be attributed to the “*global financial crisis*”. The June 30 2009 Report notes:

“The WSIB’s financial results continue to be impacted by recent increases to benefits and the current global financial crisis impacting both investment returns and premium revenues. The financial crisis is unprecedented in its magnitude and complexity resulting in a significant degree of uncertainty and rapidly changing conditions”

Global financial crisis is not the whole story

While unquestionably the financial melt-down is everything the Board suggests it is, there is a lot more going on in the contemporary workplace safety and insurance [“WSI”] system than is explained by the “*global financial crisis*”. I suggested a year ago in the October 8, 2008 issue of **The Liversidge e-Letter** (“*It’s Official: WSIB unfunded liability jumps over \$2 billion in one year!*”), that “*the market melt down will be targeted as the culprit – but the warning signs were present long before*”. I said this:

No doubt, in light of recent horrific worldwide financial events, the Board will be inclined to point to the market melt-down as the prime suspect for what are sure to be deep-seated and long-lasting woes. But, the Board and government were skating on thin ice a year ago.

Two years ago, in the September 24, 2007 issue of **The Liversidge e-Letter**, well before the “global financial crisis”, I suggested that “*the WSIB is (was) playing a long-shot*”. While last year’s melt-down was not predictable, I suggested the Board “*might pull it off*” (its funding plan) if:

- *if there are mainly financially “fair weather days” for the next seven years (certainly possible but likely?);*
- *if the equity markets don’t falter and continue to deliver phenomenal returns (possible but likely?);*
- *if there are not continued major job losses Ontario’s manufacturing and particularly the automotive sector (unlikely);*
- *if injuries continue to decline (likely);*
- *and, if time on claim is substantially reduced (unlikely).*

I said then these are a lot of “ifs” and the Board was playing a long-shot. The fact is the Board was in trouble long before the melt-down and the Board knew it.

Long-standing problems are becoming entrenched

At the same time the Board was celebrating it may be “starting to turn the financial corner” (WSIB 2006 Annual Report, p. 5), the Board attributed an 11.5% increase in benefits (2006 over 2005) to “persistence of claims over 12 months old, natural growth of locked-in claims each year, and indexing” [WSIB 2006 Annual Report, p. 26].

Expenditures have exceeded revenues for years

The problem of expenditures exceeding revenues, while certainly not eased by contemporary fiscal pressures, did not start last year. In fact, more than five years ago, the **May 28, 2004 Third Party Audit of the Workplace Safety & Insurance Board on behalf of the Minister of Labour** [“MOL 2004 Audit”], had this to say:

Addressing the unfunded liability is fundamental to achieving financial stability of the WSIB. With a forecasted deficiency of revenue over expenditures increasing the unfunded liability for a third year in a row, there are continued pressures to maintain or reduce the cost of doing business.

To put the MOL 2004 Audit in context, a short review of the progression of the UFL for the few years prior to 2004 would be instructive. The UFL hit \$11.5 billion 1993 (which was the “all time high” record until displaced recently). From 1994 to 1998, the value of benefit liabilities actually *decreased* by \$1.8 billion and by the beginning of 2002, the UFL was \$5.657 billion, its lowest since the 1980s. **Four years ago, before the “global financial crisis,” WSIB declared its “most daunting challenge” was economic**

Yet, as noted in the **2005 WSIB Annual Report**, it became clear that the world then was not all that rosy according to the Board. The **2005 Annual Report** noted that the Board’s “*most daunting challenge is economic,*” and that the WSIB faces “*financial pressures also from the growing persistency of some claims*” [WSIB 2005 Annual Report, p. 5]. The Board noted that “*2005 was another difficult year as expenses exceeded revenues*”, and that “*since 2001 the benefit liabilities increased approximately by \$3,300 million in respect to the future costs of claims*” [WSIB 2005 Annual Report, p. 19].

WSIB preparing for “adverse conditions”

In the **June 30 2009 Report**, the Board advises: In response, *in the short-term*, the WSIB has initiated a dialogue with stakeholders through the Chair’s consultations on issues and possible responses. In addition, the WSIB has initiated an efficiency and effectiveness review to control costs and improve program delivery, and set 2010 premium rates to minimize cost impacts on the majority of Ontario employers. *In the longer term* the WSIB is preparing for adverse conditions through scenario planning and identifying possible strategies to address extreme economic conditions. (p. 3)

I really have no idea what “scenario planning” the WSIB is up to. The fact is the Board is holding its cards very close to its vest, and this, I respectfully suggest, is a big, big mistake. I actually had the daring to try to discuss long-

term funding issues with senior WSIB officials this past summer in the 2010 premium “consultation” only to be advised “*this is not the forum for that discussion*”. Hmmm. If a discussion on 2010 premium rates is not the forum to address some long-term funding issues, and there is no alternative forum, I have to wonder what is? *Oh, how about this* - the funding summit I have been proposing for the better part of a year now.

The hard reality is the WSIB has no viable long-term funding plan at the moment

This is the time for extreme openness and transparency and the Board should, at this very moment, be opening its books and forging a new agreement with Ontario’s employers. Time is running short and little, if any, progress has been made on developing a renewed consensus with employer stakeholders. I wouldn’t harp on my now rather tiresome refrain for a “funding summit” if it were not so critically important. I have been suggesting this since November, 2008, and frankly, it is long overdue.

The fact is at this very moment, the Board has no viable long-term funding plan in place. The Board’s official strategic plan is the “**Five Year Strategic Plan, 2008 – 2012, Road to Zero**” which affirms the Board’s commitment to “financial stability”. This is what the Board’s **Strategic Plan** sets out (at page 27):

Financial Stability

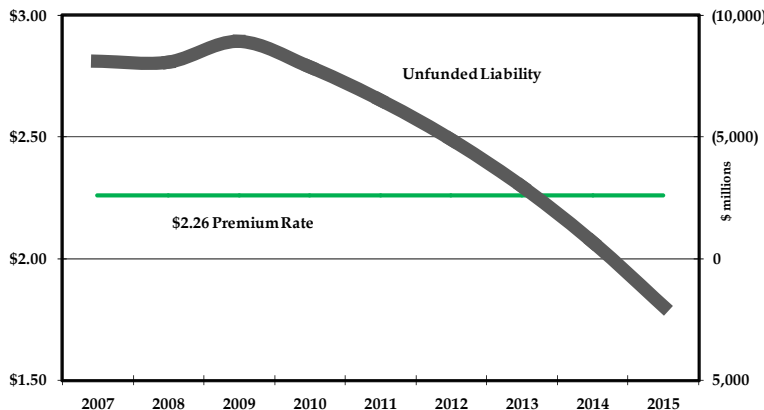
In 2005, the WSIB developed a comprehensive funding framework that has allowed us to bring stability and predictability to the average premium rate in recent years while still making progress towards elimination of the Unfunded Liability. The WSIB remains committed to a planned and disciplined approach to eliminating the Unfunded Liability and achieving full funding by 2014.

The WSIB’s funding framework is reviewed every three years, with the next review to be undertaken in 2008. By 2012, we will have made significant progress in reducing the Unfunded Liability and be well positioned to achieve our goal of full funding.

Funding Framework integral to the WSIB Strategic Plan

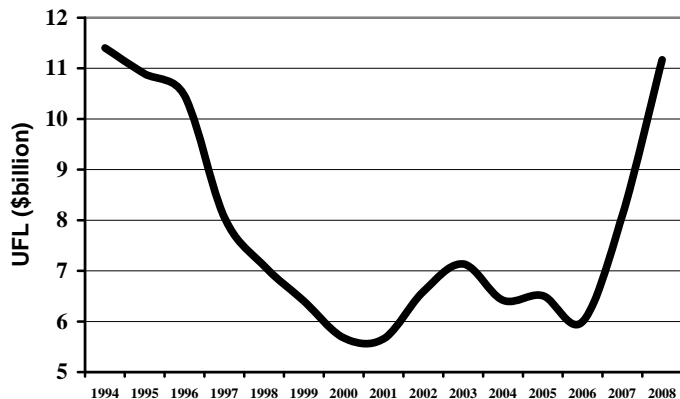
It is really the “**Funding Framework**” that forms the core of the Board’s funding strategy, and as set out in the “**Road to Zero**,” true to its commitment, the “**Funding Framework**” was reviewed in the Spring of 2008, just a few months before the commencement of the “*global financial crisis*.” Here are the *primary* elements of the contemporary WSIB funding plan:

On the UFL, “the full funding date is 2014, which was the original 30-year funding target date established in 1984” (May 2008 Funding Framework, p. 6). **Update: 2014 is toast.** The Board announced this past Spring that it officially abandoned the 2014 target (“*it will not be eliminated by 2014*”, **Steve Mahoney, speech to the Economic Club of Canada, June 16, 2009**). But, since that time, other than the ongoing **Mahoney Consultation** there has been no formal discussion to develop a new date, a new approach, or a new plan. In effect, the Board is “*playing it by ear*.”



The chart immediately above depicts what is technically the last “official” funding plan (**WSIB 2008 Funding Framework Review, Employer Stakeholders, February 11, 2008, Slide 4**). In early 2008 I must admit that I found it rather enchanting then that the Board was so bullish it was actually predicting *a surplus* by 2015! *Oops*. As I vigorously argued in the March 6, 2008 issue of **The Liversidge e-Letter**, “*WSIB reviewing funding framework*”, this was pie in the sky thinking and even then “*the milk might be turning a little sour*”. In early 2009 the Board finally declared the obvious that the 2014 full funding plan was toast. **The chart below shows why** – 2014 clearly became a lost cause (which I have suggested since 2007).

1994 - 2008 UFL



The story of today is the stark upswing from 2006, which erases all gains made over the previous 12 years. Significantly, at this point, and for the 1st time since the formulation of the 1984 thirty year full-funding plan, we don’t know the projected trajectory of the UFL. No doubt the Board is working on this as part of the “scenario planning.” But, let’s get on with that public discussion.

On the basic presumptions behind the “official plan” the Board is still sticking to the “presumptions” that: a) lost-time injury rates will decline 7% each and every year 2008 to 2012; b) that benefits will be reduced by “10 to 20 per cent by 2012”; and, c) the Board will realize an “annual target of 7 per cent long-term return” (**Funding Framework**, pp. 7-8).

How is the Board doing on these presumptions?

On lost time injury rates [“LTI”], from 2003 to 2008, the LTI rate dropped 25% (from 2.08% to 1.57%), but from 2007 to 2008 only 3% (from 1.62% to 1.57%) [**2010 Preliminary Premium Rates – Technical Information Session, September 2009, p. 14**]. Frankly, while I think that a one year 3% drop and a five year 25% drop is darned impressive, it unfortunately is not enough to “meet targets”. Maybe, just maybe, the performance is fine and the plan is screwy.

On claims durations, well, they are going up not down. Even though “*average paid claims cost has been increasing in the range of 7% to 8% per year for last 5 years (2003 – 2008)*” [**supra, page 17**] the Board nonetheless set the target for significant declines and more to the point, banked on those improvements in its **Funding Framework**. Yet, out of 100 claims, the number of claims remaining at 6-month duration increased from 6.9 in 1999 to 10.4 in 2008, an increase of 50%. Worse, the number of claims remaining at 2-year duration increased 100% from 2000 to 2008 [**ibid.**]. Frankly, the actual performance should not at all surprise the Board. Government policy (remember the **Budget Reforms** of 2007?) ensured that claims durations would increase just when this was becoming a more critical component to the Board’s long-term funding plans (as I noted in the September 24, 2007 issue of **The Liversidge e-Letter**, the **Budget Reforms** will increase long-duration claims and add to an already (even then) stressed WSIB system).

On investment returns, well, recent events speak for themselves. In the very long term (and to be fair, that is how these things are and should be measured) the Board may well meet an average of 7% per year returns. But, last year its return was -15.5%, a 22.5% negative variance over target. There is a lot of ground to cover. But, according to WSIB Chair Mahoney, the Board “*outperformed the median return of large Canadian pension funds*” [**Economic Club, June 16, 2009**]. And, in the long-term, even accounting for 2008’s dismal performance, from 1994 to 2008 inclusive, the Board realized an average return of 6.6% [**2008 WSIB Annual Report, p. 27**].

So, given all of this, what should happen? Well, one need only to look at the Board’s very own “**Corporate Governance Policy**” [**BOD Minute #13(e), February 8, 2007, Page 6865**] for the answer. The WSIB Board of Directors is required to review the 5-year strategic plan “*every 3 years, or if there has been a significant change in circumstances*” (p. 3). A “*significant change in circumstances*” has been the “new normal” since September, 2008. It’s been a year. *What’s the hold-up?* There’s no time for delay. The “**Mahoney Report**” must present the “missing links” to all of this. Stakeholders have the right to very high expectations – a *magnum opus* if you will. I don’t think I am overstating things to suggest that much of the future of the Ontario WSI scheme depends on the vibrancy of the “**Mahoney Report**” and if it falls short well, *let’s just hope that it doesn’t. Nothing less than the future is riding on it.*